LEGAL OVERVIEW OF PRIVATE ACTIVITY BOND FINANCINGS AND SUMMARY OF MUNICIPAL BOND PROVISIONS OF THE STIMULUS ACT

By Stan Raine, Sherman & Howard L.L.C., July, 2009

I. *Parties to private activity bond (conduit) financings and their roles*

A. Issuer: In a conduit transaction, the governmental issuer is both a borrower and a lender. The governmental issuer borrows money from investors by issuing bonds. (For a borrowing to be tax-exempt, the entity that is borrowing money must be a state or political subdivision or a legal entity acting as an "instrumentality" or "on behalf of" a state or a political subdivision.) But in a conduit financing, the governmental issuer is also a lender – it uses the money it borrows from bondholders to lend to other borrowers, and then uses the loan repayments received from those borrowers to repay the bondholders. Depending on the type of loan involved, the governmental issuer enters into various financing documents with the borrower, which may include a loan agreement, a promissory note, a mortgage, insurance guarantees or other security.

B. Underwriter or Placement Agent: The underwriter or placement agent is an investment banking firm that helps structure the bond issue and purchases and resells the bond. If a bank or other investor purchases the bonds directly from the issuer, the transaction is called a private placement rather than an underwriting, and there is no public offering of the bonds. If an investment banking firm helps the issuer place the bonds with the purchaser, it is referred to as a private placement agent.

C. Financial Advisor: Financial Advisors are more frequently used in competitively sold issues, where investment banking firms compete and bid for the right to sell the bonds, rather than negotiate the purchase with the issuer. But they are sometimes used in negotiated issues, as well. The benefit of independent financial advisors is that they act solely on behalf of the issuer. Although there is and needs to be a relationship of trust between the issuer and the underwriter, they are by the nature of their roles at opposite sides of the table as seller and purchaser, and an F.A. can provide an independent financial analysis of what the underwriter is telling the issuer.

D. Bond Counsel: Bond counsel is a law firm with “nationally recognized” expertise in municipal bond transactions. Investors will not buy municipal bonds unless there is an opinion of a recognized law firm to the effect that the bonds are validly issued and (in most cases) the interest on the bonds is tax-exempt. Bond counsel also should be experienced with all aspects of structuring a financing and advises the issuer and the underwriter on the legal aspects of the bond issue

E. Trustee: The trustee’s role is to represent and protect the interest of the bondholders and this usually includes holding all funds and other security for the bonds. A Trustee is almost always a commercial bank. The primary agreement signed by the Trustee is the Trust Indenture, but the Trustee may also be a party to other agreements, depending on the nature of the transaction.

F. Borrower: In conduit revenue bond financings, the Issuer issues the bonds not for its own use but to re-lend the bond proceeds to a private party which actually uses the proceeds, such as to finance an affordable housing project or a manufacturing project. The borrower can be a for-profit or a nonprofit entity. In affordable housing rental project financings, the borrower is often a limited partnership or limited liability company organized solely and only to own and operate the project. Most bond and mortgage guarantors (like FHA) require the project owner to be a "single asset" entity, meaning that the owner owns no projects other than the one being financed and conducts no business other than owning and operating the project being financed. This is generally desirable because it minimizes extraneous bankruptcy risks. In affordable housing projects, typically the developer is the general partner and 1% owner with the remaining 99% equity interest sold to the limited partners. This is particularly true in tax credit financings because the limited partners can utilize the tax credits only if they are legally a part owner of the facility.

G. Other parties

1. Disclosure Counsel
2. Underwriter’s Counsel
3. Credit Providers
4. Liquidity Providers
5. Remarketing Agent
6. Swap Counterparties
7. Swap Advisors
8. DTC
9. GIC Providers
10. GIC Brokers

II. *Bond Documents*:

A. Indenture (drafted by bond counsel):

1. This is the contract between the Trustee and the Issuer which establishes the details of the bonds. The trust indenture is the most important of the bond documents and includes the form of the bonds. An indenture will include, among other things, the following sorts of provisions:

a. the terms and provisions (maturities, interest rates and redemption rights) of the bonds;
b. the security for the bonds, which may include a project mortgage and a gross revenue pledge;
c. procedures in the event of redemption and defeasance;
d. funds and accounts;
e. permitted investments of moneys;
e. procedures for amending the Trust Indenture;
f. the Trustee's duties and rights; and
g. events of default and remedies.

2. Under the Indenture, the Issuer promises to do several things, including:

a. to cause the principal and interest to be paid on the bonds;
b. to comply with any tax covenants; and
c. to comply with the "program" covenants.

3. The Trustee has several responsibilities as well:

a. to hold all money under the Trust Indenture;
b. to pay principal and interest to bondholders; and
c to act for the bondholders in the event of a default.

B. Financing or Loan Agreement (drafted by bond counsel):

1. This is the agreement, in a revenue bond conduit financing, between the Issuer and the Borrower. Usually, they are called loan agreements, but they are sometimes called financing agreements (like in a Fannie Mae financing), or they may take other forms, such as a lease-purchase agreement or an installment sale agreement. The Loan Agreement generally includes the following:

a. terms and provisions for the loan of the bond proceeds;

b. the agreement of the Borrower to repay the loan in amounts and at times sufficient to enable the Issuer to repay the bonds;
c. security for the Borrower's repayment obligations (like a mortgage on the project being financed, and sometimes some type of third-party insurance or guaranty such as FHA insurance);
d. the Borrower's representations and warranties;
c. promises relating to maintaining, operating and insuring the project;
f. events of default by the Borrower, and remedies; and
g. the Borrower's prepayment rights.

C. Official Statement (drafted by disclosure counsel, if there is one, or by underwriter's counsel): The Official Statement is the document whereby the bonds are offered to potential investors for sale. Under federal securities laws, the Issuer (and the Borrower, if there is one) is obligated to disclose in this document all information that a "reasonable investor" would consider important in deciding whether to purchase a bond, and not to omit any information that a "reasonable investor" would consider important in that decision. A "Preliminary Official Statement," complete except for interest rates and maturities, is often used in the marketing of the bonds.

D. Purchase Contract (drafted by underwriter's counsel): This is the agreement between the Issuer and the Underwriter in which the Issuer agrees to sell the bonds to the Underwriter and the Underwriter agrees to purchase the bonds from the Issuer at a specified purchase price, and under terms and conditions set forth in the agreement. In a conduit transaction, the Borrower is usually a party to this agreement as well. The "BPA" includes provisions for various documents and opinions to be provided by parties to the financing at the closing, including any expected bond rating letters.

E. Credit Enhancement Agreement: This is the document by which a third party insures or guarantees either the bonds or the Borrower's mortgage repayment obligation. This can take the form of bond insurance or a letter of credit, or sometimes a mortgage guarantee.

F. Liquidity Agreement: These are used in connection with variable rate bond issues. They can take different forms, a common form being a Standby Bond Purchase Agreement. In variable or floating rate transactions, the bondholders have the right to put the bonds back for re-purchase at par on seven days' notice. In the normal course, the underwriter (acting as remarketing agent) will remarket those bonds to new bondholders and use the remarketing proceeds to pay the old bondholders. But to provide a backstop in the event that the remarketing agent is unable to remarket the bonds for whatever reason, the Issuer enters into an agreement with a financial institution with a solid short-term rating to provide liquidity to those tendering bondholders, so that the Issuer can keep its promise to pay those bondholders the par price of the bonds on seven days' notice even if the remarketing is unsuccessful. The liquidity provider is also there to provide liquidity for payment of bonds on certain mandatory tender events, such as upon a change in the interest rate modes that are permitted by the Indenture (for example from a weekly rate mode to a daily rate mode, a fixed rate mode, a commercial paper mode or an auction rate mode).

G. Continuing Disclosure Undertaking (drafted by underwriter's counsel): In this agreement, the Issuer, or the Borrower in a conduit financing, agrees to provide ongoing disclosure to the marketplace as required by SEC Rule 15c2-12. These are often called "secondary market" disclosures as distinguished from the "primary" market disclosures made by the Official Statement at the time of the original offering.

H. Investment Agreement: Also sometimes called a "guaranteed investment agreement" or a "GIC," this is the agreement between the Trustee (sometimes the Issuer) and a financial institution in which Indenture moneys are invested at a usually fixed rate and term, subject to withdrawal at any time without penalty when needed by the Trustee or Issuer.

H. Regulatory Agreement (drafted by bond counsel): This agreement is used in rental housing revenue bond conduit issues. It is executed by the Borrower and recorded in the property records to ensure compliance with federal tax law requirements, principally addressing the income limits for tenants.

III. *Volume cap; public hearing and approval*

A. Broadly speaking, tax-exempt bonds are often divided into two types – governmental or essential purpose bonds on the one hand, and private activity bonds on the other. Classic governmental bonds are issued to finance things public facilities like jails, schools and roads, and they also include bonds issued to finance public housing that is owned by the government itself and not a private party. Classic private activity bonds are issued to finance things like a manufacturing facility and privately owned rental housing facilities. They also include types of bonds that one might not necessarily think of as being private activity bonds, programs like single family mortgage revenue bonds and student loan revenue bonds, which benefit the public and not private businesses.

B. One of the rules that apply to most types of private activity bonds, including housing bonds, is the "public approval" requirement. As part of this process, the issuer is required to hold a public hearing (a "TEFRA hearing"), after reasonable public notice, defined to mean publication at least 14 days before the hearing in a newspaper of general circulation within the jurisdiction of the issuer. The purpose of this requirement is to give the general public the opportunity to comment on the proposed bonds and the project being financed. After the hearing and before the bonds are issued, the highest elected official of the issuer is required to approve the issuance of the bonds.

C. Another important rule that applies to most private activity bonds, except those issued as qualified 501c3 bonds or certain types of "exempt facilities" bonds, is what is referred to as the "volume cap" requirement. The purpose of this cap is to limit on an annual basis in each state the federal tax benefit resulting from the issuance of private activity bonds. The principal amount of private activity bonds each year, with some exceptions, cannot exceed the amount of applicable volume cap available in the State. The Housing and Economic Recovery Act of 2008 provided a one-time increase in the private activity bond volume cap for calendar year 2008 for "qualified housing issues," which consist of "qualified residential housing projects" (rental housing bonds) and "qualified mortgage issues" (single family bonds). For Colorado, this special volume cap was in the approximate amount of $160,000,000. The "regular" volume cap for each state is based on its population (subject to a minimum for small states – smaller than Colorado), in an amount equal to $90 per capita. This means that the 2009 limit for Colorado is about $445,000,000. The Colorado volume cap is allocated each year in accordance with a statute, under which 50% of the volume cap is allocated initially to designated statewide authorities. Most of the remaining 50% is allocated initially to local governments based on their populations, but if a local government would be entitled to less than $1,00,000 (based on $45 per capita), it does not receive any volume cap initially. The smallest government to get an initial allocation of volume cap this year was Lafayette, with Brighton just above that, both getting just over a million dollars of cap. The largest, of course, was Denver, which received an allocation of over $26,000,000. (As a reminder, these are not actual dollars, just an allocation of the right to issue private activity bonds up to the amount of the allocation.)

D. An issuer can get additional allocation in two ways – one is by agreement from another government by which it assigns all or some of its allocation to the first government. The other way is to apply for an award from what is called the statewide balance. This consists of the amount of the statewide volume cap that remains unallocated at the beginning of the year (in 2009, about $16,000,000), plus amounts that are initially allocated but then subsequently relinquished to the statewide balance, either voluntarily or by operation of law. Under the Colorado statute, whatever initial allocation that has not, by September 15 of each year, been used to issue bonds, to assign to another issuer or to "carry forward" for use in a future year, is relinquished to the statewide balance, and there is a round of applications and awards in the Fall based on those amounts.

E. The American Recovery and Reinvestment Act of 2009 provides for separate volume cap limitations for certain additional types of private activity bonds and certain taxable bonds. See Part IV below.

IV. *The American Recovery and Reinvestment Act of 2009*

A. General. On February 17, 2009, President Obama signed the American Recovery and Reimbursement Act of 2009 (the "Stimulus Act") into law. Several provisions of the Stimulus Act affect state and local governments and may present new financing opportunities. The Stimulus Act contains a number of other provisions that grant certain tax credits designed to encourage development, and provisions that provide financial relief to state and local governments generally. Following is a brief summary of the provisions of the Stimulus Act that pertain to municipal bonds.

B. Recovery Zone Bonds. The Stimulus Act creates new classes of taxable bonds and tax-exempt bonds to stimulate economic development in specified "recovery zones." The term "recovery zone" is defined as (i) any area designated by the issuer as having significant poverty, unemployment, rate of home foreclosures or general distress; (ii) any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990; and (iii) any area for which a designation as an empowerment zone or renewal community is in effect. The taxable bonds carry an imbedded tax credit and are called recovery zone economic development bonds ("RZEDBs"). The tax-exempt bonds are a new form of exempt facility bond and are called recovery zone facility bonds ("RZFBs"). The Stimulus Act creates a national volume cap limitation of $10 billion for the RZEDBs and a national volume cap limitation of $15 billion for the RZFBs. The Secretary of the Treasury is authorized to allocate the bond limitations for each type of bond among the States in the proportion that each such State's 2008 State employment decline bears to the aggregate of all States' 2008 State employment declines, provided no State shall receive less than 0.9 percent of each respective limitation. The term "2008 State employment decline" means, with respect to any State, the excess (if any) of (i) the number of individuals employed in such State determined for December 2007 over (ii) the number of individuals employed in such State determined for December 2008. Each State must then reallocate its allocation of the limitation for each type of bonds among the counties and large municipalities (populations in excess of 100,000) in such State in the proportion that each such county's or municipality's 2008 employment decline bears to the aggregate of the 2008 employment declines for all of the counties and municipalities in such State.

1. Recovery Zone Facility Bonds. RZFBs are defined as any bond issued as part of an issue in which (i) 95% or more of the net proceeds of the issue are to be used for recovery zone property; (ii) such bond is issued before January 1, 2011; and (iii) the issuer designates such bond as an RZFB. The term "recovery zone property" generally means any property that is subject to accelerated cost recovery under the Tax Code if (i) such property was constructed, reconstructed, renovated, or acquired by purchase by the taxpayer after the date on which the designation of the recovery zone took effect; (ii) the original use of which in the recovery zone commences with the taxpayer; and (iii) substantially all of the use of which is in the recovery zone and is in the active conduct of a qualified business by the taxpayer in such zone. Additionally, the term "qualified business" means any trade or business except that (i) the rental to others of real property located in a recovery zone shall be treated as a qualified business only if the property is not residential rental property and (ii) such term shall not include any trade or business consisting of the operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

2. Recovery Zone Economic Development Bonds. RZEDBs are defined as any Build America Bond (discussed generally in paragraph H below, if 100% of the excess of the available project proceeds (excess of sale proceeds over costs of issuance (not to exceed 2%), plus investment earnings on such excess) (hereinafter "Available Project Proceeds") over the amounts in a reasonably required reserve are to be used for qualified economic development purposes. The term "qualified economic development purposes" means expenditures for purposes of promoting development or other economic activity in a recovery zone,

including (i) capital expenditures paid or incurred with respect to property located in such zone, (ii) expenditures for public infrastructure and construction of public facilities, and (iii) expenditures for job training and educational programs. The issuer is entitled to receive a credit equal to 45 percent of the interest paid on RZEDBs on each interest payment date, payable directly from the U.S. Treasury. Also, see paragraph H below for information regarding the prevailing wage requirement that must be met with respect to projects financed by RZEDBs. Note that RZEDBs are not private activity bonds, and like other Build America Bonds, are an alternative to traditional tax-exempt financing for governmental purposes.

C. Build America Bonds. The Stimulus Act creates a so-called "taxable bond option" for issuers of traditional tax-exempt governmental bonds. Styled as "Build America Bonds" ("BABs"), an issuer may irrevocably elect to treat any bond (other than a private activity bond) issued before January 1, 2011, the interest on which would otherwise qualify to be tax-exempt under the Tax Code as a taxable bond. Any taxpayer holding a BAB on any interest payment date during any taxable year would be entitled to receive a tax credit equal to 35 percent of the amount of the interest payable by the issuer of the bond on such date. Alternatively, the issuer may elect to receive the credit directly so long as 100% of the excess of the Available Project Proceeds over the amounts in a reasonably required reserve are to be used for capital expenditures and the issuer irrevocably elects to receive the credit instead of the bondholder. The intent of this program is to provide issuers with the ability to issue bonds into the larger taxable market, yet still have an overall borrowing cost that is the same as, or lower than, what its cost of borrowing would be in the traditional tax-exempt market.

D. Tax Credit Bonds. The Stimulus Act creates a new category of tax credit bonds and provides additional authority for three categories of existing tax credit bonds. In particular, the Stimulus Act creates qualified school construction bonds ("QSCBs") and provides additional authority for qualified zone academy bonds ("QZABs"), new clean renewable energy bonds ("NCREBs"), and qualified energy conservation bonds ("QECBs"). Tax credit bonds are designed to provide the holders thereof with an annual tax credit in lieu of interest that typically accrues quarterly; the amount of the annual credit being determined by multiplying the applicable tax credit rate by the applicable principal amount of the bond.

1. Qualified School Construction Bonds. QSCBs are tax credit bonds issued for the construction, rehabilitation or repair of a public school facility or for the acquisition of land on which such a facility is to be constructed. In order to qualify, all of the Available Project Proceeds of the issue have to be spent for the preceding purposes, the bonds must be issued by a state or local government within the jurisdiction of which the school is located, and the issuer must designate the bonds as QSCBs. The Stimulus Act establishes a national volume cap limitation of $11 billion for QSCBs for each of 2009 and 2010, which is allocated among the States in proportion to the respective amounts each State is eligible to receive under Section 1124 of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before such calendar year. Notwithstanding the foregoing, 40% of the national volume cap limitation for QSCBs must be allocated among "large local educational agencies," defined generally as (i) the 100 local educational agencies with the largest numbers of children aged 5 through 17 from families living below the poverty level or (ii) one of not more than 25 local educational agencies that the Secretary of Education deems to be in particular need of assistance, based on a low level of resources for school construction, a high level of enrollment, or certain other factors. State allocations are reduced by the amount of any allocations to "large local educational agencies" within such State. Also, see paragraph H below for information regarding the prevailing wage requirement that must be met with respect to projects financed by QSCBs.

2. Qualified Zone Academy Bonds. QZABs are tax credit bonds issued by qualified issuers for the benefit of "qualified zone academies." Generally speaking, a school is a qualified zone academy if (i) the school is a public school that is designed or has a program designed to cooperate with business to enhance the academic curriculum, increase graduation and employment rates, and better prepare students for the rigors of college and the workforce; (ii) students in the school or program will be subject to the same academic standards as other students educated in the school; (iii) the comprehensive education plan of the school or program is approved by the eligible local education agency; and (iv) such school is located in an

empowerment zone or enterprise community or there is a reasonable expectation that at least 35% of the students attending the school or participating in such program will be eligible for free or reduced-cost lunches. The Stimulus Act increases the national volume cap limitation for QZABs from $400 million to $1.4 billion for 2009 and sets the national volume cap limitation at $1.4 billion for 2010. The national volume cap limitation is allocated among the States on the basis of their respective populations of individuals below the poverty line. 95% of QZAB proceeds must be spent for "qualified purposes," generally defined as (i) the rehabilitation or repair of public school facilities; (ii) providing equipment for use in such school facilities; (iii) developing course materials for education to be provided in such public school facilities; and (iv) training teachers and other school personnel in such school facilities. The issuer of such bonds must be a state or local government within the jurisdiction of such qualified zone academy, the bonds must be designated as QZABs, and certain private contributions having a present value of not less than 10% of the proceeds of the issue must be obtained prior to issuing QZABs. Also, see paragraph H below for information regarding the prevailing wage requirement that must be met with respect to projects financed by QZABs.

3. New Clean Renewable Energy Bonds. NCREBs are tax credit bonds issued by qualified issuers to finance facilities that generate electricity from wind, closed-loop biomass, open-loop biomass, geothermal or solar, small irrigation, landfill gas, trash combustion or hydropower. Qualified issuers are defined as public power providers, cooperative electric companies, governmental bodies, clean renewable energy bond lenders, or not-for-profit electric utilities which have received a loan or loan guarantee under the Rural Electrification Act. The Stimulus Act authorizes an additional $1.6 billion for NCREBs. Of this authorization, not more than one-third may be allocated to qualified projects of public power districts, not more than one-third may be allocated to qualified projects of governmental bodies, and not more than one-third may be allocated to qualified projects of cooperative electric companies. All of the Available Project Proceeds of NCREBs issues must be spent on the qualified renewable energy facilities described above, and the issuer must designate such bonds as NCREBs. Also, see paragraph H below for information regarding the prevailing wage requirement that must be met with respect to projects financed by NCREBs.

4. Qualified Energy Conservation Bonds. QECBs are tax credit bonds issued by qualified issuers for qualified conservation purposes. The term "qualified conservation purpose" means:

(i) capital expenditures incurred for purposes of reducing energy consumption in publicly-owned buildings by at least 20 percent; implementing green community programs; rural development involving the production of electricity from renewable energy resources; or any qualified facility (other than Indian coal and refined coal production facilities), as defined in Section 45(d) of the Internal Revenue Code of 1986, as amended (the "Code");

(ii) expenditures with respect to research facilities, and research grants, to support research in (a) development of cellulosic ethanol or other nonfossil fuels, (b) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels, (c) increasing the efficiency of existing technologies for producing nonfossil fuels, (d) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation, or (e) technologies to reduce energy use in buildings;

(iii) mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting;

(iv) demonstration projects designed to promote the commercialization of (a) green building technology, (b) conversion of agricultural waste for use in the production of fuel or otherwise, (c) advanced battery manufacturing technologies, (d) technologies to reduce peak use of electricity, or technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity; and

(v) public education campaigns to promote energy efficiency.

QECBs were originally authorized in the fall of 2008 as a component of the TARP legislation. The Stimulus Act increases the national limitation for QECBs from $800 million to $3.2 billion. Generally speaking, allocations of QECBs will be made to the States in proportion to the population of the States. However, the Stimulus Act requires that "large local governments" be allocated a portion of such State's allocation which bears the same ratio to the State's allocation as the population of such large local government bears to the population of such State. The term "large local government" is defined as any municipality or county if such municipality or county has a population of 100,000 or more. QECBs may be issued by State or local governments. Indian tribal governments may also issue QECBs to the extent such bonds are issued for purposes that satisfy the present law requirements for tax-exempt bonds of tribal governments, and may be able to issue QECBs for any qualified conservation purpose depending on the future interpretation of the impact of the Stimulus Act's provisions on tribal economic development bonds. All of the Available Project Proceeds of a QECB issue must be used on one or more qualified conservation purposes and the issuer must designate such bonds as QECBs. Also, see paragraph H below for information regarding the prevailing wage requirement that must be met with respect to projects financed by QECBs.

E. Tribal Economic Development Bonds. In most cases, the ability of Indian tribes to issue tax-exempt bonds is more limited than that of state or local governments. The proceeds of tribal bonds must be used to fund an "essential government function," which does not include many of the projects that are available to other tax-exempt issuers. The Stimulus Act authorizes the Secretary of the Treasury, in consultation with the Secretary of the Interior, to allocate a total of $2 billion of tax-exempt bonds to be issued by tribal governments that are not subject to the "essential government function" requirement. Such bonds will be designated by the tribal government as tribal economic development bonds ("TEDBs") and will be tax-exempt if the same bonds would be tax-exempt if issued by a state or local government. However, TEDBs may not be used to fund certain gaming facilities or facilities outside the Indian reservation. The Stimulus Act further requires the Secretary of the Treasury to perform a study on the effects of this program within a year and to report the results to Congress, including whether the essential government function test should be removed or modified for all tribal bonds.

F. Changes to Bank Qualification and Other Provisions Affecting Financial Institutions. Generally speaking, banks and other financial institutions may not take tax deductions for much of the interest cost associated with investing in tax-exempt bonds. In past years, the Tax Code has allowed an exception to this rule that allowed financial institutions to deduct 80% of the interest allocable to investments in tax-exempt bonds that are "bank qualified." For this reason, issuers of bank qualified bonds can often issue bonds that will be purchased by financial institutions with lower interest rates. Bank qualified bonds are those issued by "qualified small issuers." Since 1986, a qualified small issuer was one that reasonably anticipated issuing $10 million or less in tax-exempt obligations (with certain exceptions) during the calendar year. The Stimulus Act raises the $10 million limit for qualified small issuers to $30 million per year for 2009 and 2010. Thus, any issuer that reasonably anticipates issuing $30 million or less in tax-exempt obligations in 2009 and/or 2010 may issue bank qualified bonds during the applicable year. Further, for the first time, the Stimulus Act specifies that bonds issued by political subdivisions on behalf of 501(c)(3) organizations do not count against the political subdivision's annual limit, but instead each 501(c)(3) borrower is treated as an "issuer" subject to its own $30 million annual limit. In addition, the Stimulus Act allows financial institutions to deduct interest allocable to non bank-qualified bonds as if the bonds were bank qualified, but the bonds treated in this manner may not exceed two percent of the financial institution's assets. This provision applies only to bonds issued in 2009 and 2010, and will not apply to refundings of bonds issued before 2009 as refunding bonds are treated as issued during the year in which the refinanced new money obligation was issued.

G. Limited Repeal of Alternative Minimum Tax Applications to Tax-Exempt Bonds. In past years, interest on tax-exempt private activity bonds was subject to the alternative minimum tax and interest on all tax-exempt bonds was required to be included in calculating the "adjusted current earnings" adjustment applicable to corporations for purposes of computing the alternative minimum taxable income of corporations. These provisions made the affected tax-exempt bonds less attractive to some investors, which generally led to higher borrowing costs. The Stimulus Act provides that neither of these alternative minimum tax provisions will apply to bonds issued in 2009 and 2010. Refunding bonds are considered issued for the purpose of the repeal on the date the refinanced new money obligation was issued. However, the Stimulus Act also removes the alternative minimum tax applications with respect to bonds issued in 2009 or 2010 to refund bonds that were issued from 2004 through 2008. This provision will have the greatest impact on private activity bonds but will also affect governmental bonds that are purchased by corporations.

H. Prevailing Wage Requirement. Historically, federal law has not required any particular labor standards be enforced with respect to projects financed with tax-exempt bonds. However, the Stimulus Act applies the "prevailing wage" requirements applicable to certain federal projects, more commonly known as "Davis Bacon," to projects financed with the proceeds of any NCREB, QECB, QZAB QSCB OR RZEDB issued after the date of enactment of the Stimulus Act. It should be noted that this requirement is not applied to Clean Renewable Energy Bonds issued pursuant to the statute existing prior to the Stimulus Act (pursuant to Section 54 of the Tax Code) as opposed to New Clean Renewable Energy Bonds that are governed by the Stimulus Act (Section 54C of the Tax Code). The U.S. Government Printing Office maintains a website explaining the Davis Bacon requirements and setting forth the required wage rates at http://www.gpo.gov/davisbacon/.

I. Qualified Small Issue Private Stimulus Activity Bonds. Prior to the adoption of the Stimulus Act, qualified small issue private activity bonds could be issued to finance manufacturing facilities and directly related and ancillary property; provided that the directly related and ancillary property could not exceed 25% of the bond proceeds. The Stimulus Act provides that bonds issued in 2009 and 2010: (a) may be used to finance facilities that create or produce "intangible property," which consists of many forms of intellectual property; and (b) may be used to finance directly related and ancillary property without regard to the 25% limitation so long as the ancillary property is located on the same site as the manufacturing property.
